

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ANTHONY AND MARGHERITA FUSCO	:	DETERMINATION
for Redetermination of a Deficiency or for	:	
Refund of New York State and New York City	:	
Income Taxes under Article 22 of the Tax Law	:	
and Chapter 46, Title T of the Administrative	:	
Code of the City of New York for the Years	:	
1981 and 1982.	:	

Petitioners, Anthony and Margherita Fusco, 530 Oak Avenue, Staten Island, New York 10306, filed a petition for redetermination of a deficiency or for refund of New York State and New York City income taxes under Article 22 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York for the years 1981 and 1982 (File No. 802359).

A hearing was held before Joseph W. Pinto, Jr., Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on June 11, 1987 at 1:15 P.M., with all briefs submitted by August 14, 1987. Petitioners appeared by Townsend Rabinowitz Pantaleoni & Valente, P.C. (David Schmulde, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Irwin A. Levy, Esq., of counsel).

ISSUE

Whether the Audit Division properly asserted additional income tax due against petitioners for the years 1981 and 1982 based upon its refusal to accept petitioners' redirection of wage and tax statement income into Federal Schedule C income and ultimately into a corporation.

FINDINGS OF FACT

1. Petitioners, Anthony and Margherita Fusco, timely filed New York State income tax resident returns for the years 1981 and 1982. The 1981 and 1982 returns indicated petitioner Anthony Fusco's occupation as "order clk" (order clerk). In fact, Anthony Fusco was an independent trader in commodities employed by various firms during the years 1981 and 1982. The 1981 return indicated petitioner Margherita Fusco's occupation as housewife and the 1982 return indicated her occupation as secretary. The 1981 return reported total income of \$34,682.00, with wages reported on schedule "A" of \$34,988.00. However, attached to the return were wage and tax statements ("W-2's") issued to petitioner Anthony J. Fusco in the following amounts:

<u>ISSUER</u>	<u>AMOUNT</u>
Unified Securities Corporation	\$20,806.83

S. D. Cohn Company	20,480.75
Total	<u>\$41,287.58</u>

Also attached to said return were two wage and tax statements issued by Margo Equities, Inc. to both petitioners, one to Anthony Fusco listing wages of \$4,700.00, the other to Margherita Fusco listing wages in the sum of \$4,000.00. The discrepancy between the income reported on the wage and tax statements and that reported by petitioners on their schedule "A" was attributable to the transfer of \$15,000.00 in income from the wage and tax statements to Schedule C.

It was evident from the wage and tax statements attached to the 1981 and 1982 New York State and City of New York resident income tax returns that petitioners derived all of their income as employees of the various firms issuing the W-2's.

2. A copy of Federal Schedule C, listing a proprietor's name of "Anthony Fusco", was attached to the return and indicated gross receipts of \$43,728.00. This figure was broken down on a separate statement as gross receipts of \$28,728.00 and a "transfer from Schedule C" of \$15,000.00. There was also listed an item "cost of goods sold and/or operations (Schedule C-1, line 8)" set forth as \$32,841.00. The cost of goods sold was subtracted from the gross receipts yielding a total income of \$10,887.00. The following deductions were listed beneath said income:

<u>DEDUCTIONS</u>	<u>AMOUNT</u>
Bank service charges	\$ 30.00
Car and truck expenses	2,719.00
Dues and publications	222.00
Laundry and cleaning	37.00
Legal and professional services	400.00
Office supplies and postage	713.00
Repairs	75.00
Travel and entertainment	4,410.00
Utilities and telephone	175.00
Miscellaneous	<u>173.00</u>
Total	\$8,954.00

The \$8,954.00 in deductions, when subtracted from the \$10,887.00 in total income, resulted in \$1,933.00 in net profit reported by petitioners. This amount was incorporated on their New York Schedule A, "total income" schedule, which, when combined with the reported wages of \$34,988.00 and a capital loss of \$2,239.00, yielded the reported total income figure stated above of \$34,682.00.

3. The 1982 New York State and City of New York Resident Income Tax Return reported total income of \$119,266.00 after Federal and New York State adjustments to income. This total amount included wages of \$120,774.00, interest income of \$2,690.00, refunds of State and local income taxes of \$117.00 and a business loss of \$5.00. It is noted that Schedule C filed with the 1982 return reported a business loss of \$204.00. The wage and tax statements attached to the return showed wages paid to Anthony J. Fusco by Stuart Brothers in the sum of \$29,355.28 and wages from Unified Securities Corporation paid to Anthony J. Fusco in the sum of \$110,018.51. There were also two W-2's issued by Margo Equities, Inc., one each to Margherita Fusco in the sum of \$8,200.00 and Anthony Fusco in the sum of \$8,200.00.

A Federal Schedule C, listing the proprietor's name as "Anthony Fusco", was attached to said return and indicated gross receipts of \$35,000.00, noted to be a "transfer from W-2". The following deductions were listed beneath said income:

<u>DEDUCTIONS</u>	<u>AMOUNT</u>
Bank service charges	\$ 51.00
Car and truck expenses	326.00
Commissions	29,940.00
Depreciation and section 179 expense from Form 4562	793.00
Travel and entertainment expense	3,663.00
Utilities and telephone	431.00
Total	\$35,204.00

The \$35,204.00 in total deductions subtracted from income of \$35,000.00 resulted in a business loss of \$204.00. As noted above, this amount was reported as a business loss of \$5.00 on Schedule A.

4. For the year 1981, petitioners chose the standard deduction while in 1982 they itemized their deductions as follows:

<u>1982</u>	
<u>ITEMIZED DEDUCTIONS</u>	<u>AMOUNT</u>
Total taxes	\$15,418.00
Total interest expense	4,987.00
Total contributions	<u>751.00</u>
Total Federal itemized deductions	\$21,156.00
Income tax included in Federal itemized deductions	<u>(12,447.00)</u>
Net New York itemized deductions	\$ 8,709.00

5. On or about February 5, 1981, Margo Equities, Inc. filed a Certificate of Incorporation with the New York State Secretary of State. On April 24, 1981, a business certificate was filed by petitioner Anthony Fusco declaring that he was conducting or transacting business under the name of Margo Equities. During the years in issue, petitioners were the sole shareholders and officers of Margo Equities, Inc. From all of the evidence adduced at hearing, it appears that Margo Equities, Inc. was properly organized and existing under the laws of the State of New York and in full compliance with Federal and State tax laws. The corporate address was petitioners' home address, 530 Oak Avenue, Staten Island, New York, and the principal business activity was declared as "consulting". The Federal corporation income tax returns filed on behalf of the corporation for the fiscal years ended September 30, 1982 and 1983 listed Anthony Fusco and Margherita Fusco as the sole shareholders and the New York corporation franchise tax reports for the same fiscal years listed Anthony and Margherita Fusco as president and vice president, respectively.

6. Certain amounts of money were paid to Margo Equities, Inc. for services rendered by it to petitioners. These amounts were subtracted from gross receipts as cost of goods sold on the 1981 Federal Schedule C and deducted as commissions paid to Margo Equities, Inc. on the 1982 Federal Schedule C. The Schedule C's were attached to petitioners' 1981 and 1982 New York

State and City of New York resident income tax returns. Although the Audit Division requested substantiation of the Federal Schedule C deductions, specifically the commissions paid to Margo Equities, Inc., petitioners never produced any documentation. The Audit Division also asked for further information in order to understand petitioner Anthony Fusco's duties performed for his various employers and their reimbursement policies in order to determine whether or not it was ordinary and necessary for petitioners to incur the kinds of deductions they claimed on their Schedule C's, but said documentation was also never produced by petitioners.

7. On February 14, 1985, the Audit Division issued to petitioners a Statement of Personal Income Tax Audit Changes for the years 1981 and 1982. Because no documentation was forthcoming with regard to the Schedule C income or deductions, the Audit Division disallowed the transfer of income from the wage and tax statements to the Schedule C proprietorship and thereby also disregarded commissions paid to the corporation, Margo Equities, Inc. The Statement of Personal Income Tax Audit Changes set forth the following information:

	<u>1981</u>	<u>1982</u>
Corrected taxable income	\$35,239.00	\$127,355.00
Tax on corrected taxable income per IT-250	2,883.00	12,194.00
New York City tax	1,115.00	5,076.00
New York City tax surcharge		254.00
Corrected tax due	3,998.00	17,524.00
Tax previously computed	3,026.00	13,937.00
Total additional tax due	972.00	3,587.00
Interest	331.00	686.00
Total	\$ 1,303.00	\$ 4,273.00

The explanation provided by the Audit Division on said statement read as follows:

"Since you failed to provide documentation to substantiate the items requested, your taxable income has been revised based upon available information on file."

8. On May 29, 1985, the Audit Division issued to petitioners a Notice of Deficiency for the tax years 1981 and 1982 which set forth additional tax due of \$4,559.00 and interest of \$1,083.07 for a total amount due of \$5,642.07.

SUMMARY OF PETITIONERS' POSITION

9. Petitioners argue that their deductions were disallowed for no valid reason. Petitioners argue that all the amounts received by Mr. Fusco were included in gross income and reported on tax returns by Margo Equities, Inc. Petitioners contend that the purpose of creating and using Margo Equities, Inc. was to consolidate the operations of petitioners' bookkeeping and to bring continuity to a business which was constantly changing and involved with different employers.

CONCLUSIONS OF LAW

A. Petitioner Anthony Fusco was employed in the years 1981 and 1982 as an independent trader of commodities. Anthony Fusco was undeniably an employee of Unified Securities

Corporation, S. D. Cohn Co. and Stuart Bros. during 1981 and 1982. His compensation was recorded on wage and tax statements, although he did not report all of said income as wage income on his returns for 1981 and 1982.

Petitioners created Margo Equities, Inc. in order to simplify their recordkeeping and centralize their operations. The corporation basically performed bookkeeping services for petitioners. Payments were made to Margo Equities, Inc. and termed "commissions" for services rendered. In addition to the commissions paid to Margo Equities, Inc. in 1981 and 1982, amounts were also deducted on Federal Schedule C's as ordinary and necessary business expenses. However, petitioners did not provide any documentation or substantiation for gross receipts or deductions.

In any event, the returns were erroneously prepared and the Audit Division was justified in disallowing the Schedule C business expenses given petitioners' failure to substantiate gross receipts and deductions reported on their Federal Schedule C's. Petitioners have not sustained their burden of proof under Tax Law § 689(e) and Administrative Code § T46-189.0(e). Petitioners have not shown that they were engaged in a trade or business other than as employees.

Former section 62 of the Internal Revenue Code provided for the deductibility of "trade and business deductions" in the determination of adjusted gross income. Such deductions were defined as follows:

"The deductions allowed...which are attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee." (IRC § 62[1].)

Further, for the purpose of being classified as a trade or business, the activities of petitioners must have been carried on for profit or potential profit (see ___ IRC § 183[a]). Petitioners must have undertaken an activity with the expectation of making a profit, and hold themselves out to others as engaged in the selling of goods or services (*Gajewski v. Commissioner*, 723 F2d 1062). Petitioners have not sustained their burden of proving that they fulfilled any of these requirements.

Thus, expenses claimed on the Schedule C's may not be deducted under former section 62(1) of the Internal Revenue Code. Petitioners' scheme to divert W-2 income properly reportable as wages to Federal Schedule C and ultimately to Margo Equities, Inc. is an invalid tax avoidance device.

B. While it is possible that petitioners might have been entitled to deduct certain employee business expenses under former sections 62(2) or 63(f) of the Internal Revenue Code by filing a Form 2106, or by itemizing deductions and claiming such expenses as miscellaneous deductions, said expenses are not deductible as reported by petitioners on their 1981 and 1982 New York State income tax returns.

C. The petition of Anthony and Margherita Fusco is denied and the Notice of Deficiency issued on March 29, 1985 is sustained, together with such additional interest as may be lawfully owing.

DATED: Albany, New York
July 8, 1988

_____/s/_____
ADMINISTRATIVE LAW JUDGE